THE COST OF DISTRIBUTING GROCERIES

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Current discussions of the cost of living and experiments in reducing it find the position of the retail grocer very strong. There is a demand for his services and no plan that involves his complete elimination can succeed. Mail order houses and factories selling direct to the consumer have taken a part of his trade but thus far they are able to do nothing more than lessen his business. They are not able completely to displace him. Coöperative stores and the chain store are merely modifications of the retail store and not at all a substitute for it.

The reason is to be found in the nature of the demand for the grocer's services. The housewife lacks a large store room and so must buy in small quantities rather than in bulk. A limited supply of cash makes impossible large purchases from a distant point. Vegetables and fruits must be fresh, while many articles are not sufficiently standardized to be purchased without examination. Unexpected guests and other emergencies create demands that must be promptly met. A lack of foresight in buying makes a local supply a convenience if not an actual necessity. These reasons and others seem to insure a steady, continued demand for the retail grocer.

This demand, however, is merely a demand for a local supply of groceries, vegetables and fruit and not a demand for highly skilled service. A grocery store offers the opportunity for a very high degree of efficiency. Care in purchasing only the goods for which there is a demand and in the proper quantities, skill and tact in securing and retaining customers and discrimination in the extension of credit call for business foresight and ability. Yet it is possible to conduct a grocery store with very little capital and with no experience. Two hundred dollars will purchase a fair stock of goods, while an even smaller sum may be invested in a few groceries to be carried as a side line in connection with a meat shop or a delicatessen store. Lack of experience may be a handicap but it does not debar any one from starting business.

As a result the retail grocery field is highly competitive. Entrance is easy. Although customers may be few and profits nil, the store may continue for a considerable period. The wife or the children may wait upon the customers while the husband and father works elsewhere at his trade. Little is invested and little is lost in case of failure. Some of the stock is not quickly perishable and may, in case of need, be consumed by the grocer's family, or perhaps sold to fair advantage if creditors press their demands.

The grocer who is entirely dependent upon his store is thus forced into severe competition. The profit on each article sold is small and it is easy for him to be drawn into price cutting. Demand for many articles is hard to determine, and the end of the season will find the careless buyer with his shelves full of goods that must be carried into the next year. While many of the commodities handled are not readily perishable, fresh fruits and vegetables are an important and expensive exception. Items of direct expenditure bulk large. Clerks, order boys and delivery boys must be paid. Small orders must be delivered at a distance to avoid offending customers. Trading stamps and other kinds of premiums must perhaps be used to attract trade. Petty thieving and carelessness among employees are hard to detect and very difficult of correction. Credit must be extended to customers with frequent heavy losses and always a temporary employment of capital in an unprofitable manner. Trade varies so widely from hour to hour and from day to day that it is hard to keep employees working regularly.

All this emphasizes the necessity of careful management. It is estimated that the grocer must make from 15 per cent to 20 per cent gross profit in handling his goods and that "any one whose expenses do not run over 17½ per cent has cause to congratulate himself." But this margin of gross profit is hard to secure.[1]

Butter and eggs together are said to represent about 36 per cent of the grocer's total sales and yield about 10 per cent profit. Sugar

[1] A prominent grocer from the Pacific coast not long ago declared: "On the coast we handle no meats—only groceries and some liquor in sealed packages . . . . Sixty per cent of our business pays only from 10 per cent to 12 per cent while the majority . . . . need 17 per cent. In most cases there is a large loss, i.e. from 5 per cent to 8 per cent, hence a large profit must be added to other goods. We practically rob customers on teas and coffees to make up the balance." (*Grocers' Review*, July, 1910, p. 246.)

represents 7 per cent and always sells on a very narrow margin. Flour yields 16 per cent profit, but ham, bacon and lard less than 5 per cent. Eggs, butter, sugar, smoked meats, lard, bread, flour and potatoes represent about 60 per cent of the total sales and show the retailer an average gross profit of only about 9 per cent. Evidently a large profit must be derived from other lines of goods if the grocer is to survive.[2]

With this narrow margin of gain a frequent turn-over of invested capital is necessary and the ideal kept in mind is an entire change of stock once each month or twelve times per year. Needless to say this ideal is seldom attained. Careful, intelligent grocers with fair credit can and do make good profits if conditions are at all favorable but it is evident that many who are easily drawn into the trade may lack these qualities and find the pressure of competition very keen. For the independent dealer the problem has in recent years been complicated by the appearance of the chain stores—a number of stores under a single management from a central office. The economies gained from such concentration give them a distinct advantage and their competition is one of the most serious obstacles the independent grocer must face.

The result of the conditions just cited may be illustrated by the situation in Philadelphia. In 1911 there were in the city 5,266 retail grocery stores besides 257 delicatessen stores that sell some groceries and 2,004 butchers and retail meat dealers, of whom probably 10 per cent or 200 also sold groceries. A total of these three groups gives 5,723 but does not include a large number of stores dealing in a variety of articles and hence hard to classify. Some of these also compete with the regular grocers. If we limit the discussion, however, to the 5,723 stores named, a comparison with the population of the city which was 1,549,008 in 1910, shows one store for every 270 people or one for every 54 families. Or if only the 5,266 stores are included there is one store for every 294 people or one for every 59 families.

The grocery business is carried on in several ways. By far the larger part is conducted by the independent proprietor who purchases most of his dry groceries from the wholesaler and his vegetables and

[2] These estimates have been furnished to the writer by Secretary Reno Schoch of the Retail Grocers' Association of Philadelphia, who with the other officers of the Association has been very courteous and helpful in giving assistance.

fruit from the commission merchant. A second group is the chain-stores. Each system of these stores is managed from a central office and goods are purchased from a wholesale firm perhaps separately incorporated but in any case owned and operated by the same interests as the retail stores. They thus have several advantages. They sell for cash, eliminating losses from bad debts and securing a quick turn-over of capital and the benefit of cash discounts on their own purchases. They buy in large quantities from the wholesaler or direct from the manufacturer, thus getting quantity prices. A very high degree of efficiency in operation is brought about by the employment of high grade managers at the central office.

A third group is made up of those independent grocers who have organized into associations to promote their common interests. In addition to the ordinary activities of trade bodies they have in recent years been carrying on a sharp contest with the jobbers and with the chain stores.

This somewhat lengthy description justifies the assertion that the ordinary method of distributing groceries is expensive both to the grocer and to the general public. The goods pass from the manufacturer through the hands of the wholesaler who adds 10 per cent to the price, and then to the retailer who adds an additional 20 per cent before they reach the consumer. The 20 per cent profit of the retailers is not sufficient for those who are hopelessly incompetent, but is more than would be necessary under a more efficient régime. The buying public is paying a price that is fixed by the needs of what the technical economist would call the "marginal grocer" whose ability is small. He exists because of the demand for his services and because of the ease of entering the business as described above. To these reasons for the expense of grocery distribution are to be added careless purchases by the housewife, the cost of an elaborate order and delivery service, the burden of trading stamps and premiums and numerous other items that need not be enumerated in detail.

The present period of rising prices has subjected the grocer and other retailers to a heavy pressure. They are compelled to pay more for their purchases but find great difficulty in raising their prices to the consumers. Profits are thus lessened and many have failed. The rest are seeking for a solution of the problem that will lessen their burdens and are finding that solution in several different forms.

To understand the situation it is necessary to observe some of

the forces that tend to perpetuate the present system of distribution. Manufacturers, wholesalers and retailers have from time to time shown their approval of it, contending that its continuance is for the advantage of all parties concerned. A few illustrations of this attitude will make the point clear. On April 6 and 7, 1909, there was held in New York City a conference attended by representatives of the American Specialty Manufacturers' Association, the National Wholesale Grocers' Association and the National Retail Grocers' Association. At this meeting a resolution was passed that the specialty manufacturers should fix the price to the consumer but that the prices should not be placed by the manufacturers on the package. Another action taken was the following:

> Resolved, That it is the sense of this conference that we are opposed to the factory-to-family plan, because it is a trade demoralizer and, in itself, is degrading.
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> That the conferees representing various interests here acquaint their members with the dangers of this movement and that they urge them to instruct their employees to do what they can to educate the public as to the fallacy of the theory that the factory-to-family plan means an economy to the family, and that the regular channel of distribution is from the retailer to the consumer, that the same is the most economical means of delivering goods to the consumer; and is in that manner a protection to the consumer.

In the same year the A. & W. Thum Company, manufacturers of "tanglefoot" fly paper decided to supply "only such of the wholesale trade as maintain the manufacturers' fixed selling price;" also the N. K. Fairbank Company began to paste on each package of its product a sticker specifying that the goods were sold only on condition that they were retailed at no less than specified prices, and declaring both wholesaler and retailer liable to the N. K. Fairbank Company to the amount of $50 for each breach of this condition not as a penalty but as liquidated damages, a method generally known as the "Pacific Coast Plan." The Kellogg Toasted Corn Flake Company has a similar plan, selling only to wholesalers and endeavoring to maintain a uniform retail price of ten cents a package.

This attitude against price cutting has also received support in the action of the New Jersey legislature which at its last session passed a bill entitled "A bill to prevent unfair competition." This bill which became a law with the governor's signature definitely forbids discriminating against the goods of any manufacturer "by depre-

ciating the value of such products in the public mind, or by misrepresentation as to value or quality, or by price inducement, or by unfair discrimination between buyers, or in any other manner whatsoever, except in cases where said goods do not carry any notice prohibiting such practice and excepting in case of a receiver's sale or a sale by a concern going out of business."

The organization of the grocery business as we have described it is thus strongly defended. Its two aspects that affect the cost of goods to the consumer are (1) the distribution of goods only through both the wholesaler and the retailer, and (2) the maintenance, if possible, of a retail price determined by the manufacturer. To this may be added the practice of offering trading stamps and premiums as trade inducements, but this is not such an essential part of the general system as the other two features.

An attack on these methods of distribution was inevitable. Too many parties with diverse interests are involved to make unanimity of action possible. Even the manufacturers, though relatively few in number, are difficult to hold together. The wholesalers are the ones most in danger in a reorganization and so are more easily controlled but the retailers are numerous and of diverse interests. A modification of methods of distribution is less apt to injure them and besides, many of them are not far-sighted enough to understand what may be for their own best interests.

The system is weakening in the two features mentioned. The first move has been toward the elimination so far as possible of the wholesaler as a distributive factor and the attack upon him has come in four different ways.

The first of these is the chain stores which have already been described. At first small in size and strength they grew until they became a serious menace to the independent retailer and finally to the jobber. The manufacturer found it profitable to pass over the jobber and sell his goods direct to the retail stores. Naturally enough the wholesaler protested but the influence of the chain stores was too great. The chain stores also organized as wholesale houses and claimed the same right as other wholesalers to buy direct from the manufacturer.

The second attack has come from the associations of independent retail dealers. By combining their orders they found it possible to take advantage of quantity prices in purchasing from the wholesaler.

This led to the next step which was purchase direct from the manufacturers. Again the wholesaler objected, but again he lost because of the strength of his opponents. In some cases, as in Philadelphia, the retailers' associations formed separate organizations which were incorporated to do a wholesale business but saved their profits for the retail grocers who owned all the stock. Ordinarily the wholesaler adds 10 per cent to the cost of the goods he handles. The chain stores and the retailers' associations can do the work for much less than one-half this and are the gainers by that amount.

It is to be noted that in neither of the cases just described does the consumer benefit except in so far as the retailer allows him to share in the savings effected. Retail prices may or may not be lowered. Also the manufacturers are clinging to the form of selling only to wholesalers since the chain stores and retailers' associations are so organized. Although this distinction is largely technical, it still exists and so long as it is observed one may urge that the system of distribution is still intact.

However that may be, even the outward form is beginning to disappear. Some manufacturers are offering to sell direct to the retailer—a third method of attacking the wholesaler. Thus the Proctor & Gamble Distributing Company which deals in the products of the Proctor & Gamble Company, have recently gone direct to the retail trade in Greater New York, Rockland and Westchester counties, New York, and all of New Jersey as far south as and including Trenton. They still furnish their products to jobbers in that territory but on the same basis as to the retail grocers.

A fourth attack is on quantity prices. Thus far the small dealer has been handicapped in his struggles by the fact that the wholesalers, the chain stores, the retailers' associations and the large independent dealers have been able to purchase at a lower price because buying in large quantities. A determined effort is being made now to check this practice. Among the manufacturers who have already abandoned the plan is the American Tobacco Company, which, however, sells only to the wholesalers. The result of the contest will probably not be the entire elimination of the wholesaler, but merely a lessening of his importance. He will doubtless retain his position but will handle a smaller proportion of the total supply of groceries than in the past.

A movement has also been directed against the fixing of retail

prices by the manufacturer. Much can be said in favor of the practice as a protection to the wholesaler, the retailer and the consumer as well as to the manufacturer. The manufacturer contends that his goods will be energetically handled by the wholesaler and retailer only in case there is a fair margin of profit to be realized. If prices are cut by one dealer the others must follow and all lose. On the other hand if a fixed price could be maintained there would be a fair profit for all. The consumer also would gain. Prices would be certain instead of irregular and he would not be compelled to pay more for other goods to offset the grocer's losses on goods whose prices had been cut.

Methods of maintaining prices have varied but the usual ones have been those described above as practiced by the N. K. Fairbank Company and others. The difficulty has been in controlling both wholesalers and retailers. The only way to coerce them has been to bring action for violation of contract or for liquidated damages. This has brought the whole matter before the courts who have been called upon to determine the legality of such agreements. The issue hinges upon the interpretation of the Sherman Anti-Trust Law and the statutes of the various states against agreements in restraint of trade.

Two classes of cases have arisen. The first involved the right of the manufacturer to dictate the retail selling price of articles not patented and was settled by the United States Supreme Court in Dr. Miles Medical Co. v. John D. Park & Sons (220 U.S. 373). The court held that while a manufacturer is not bound to make or sell goods this fact does not prove that he may impose every sort of restriction upon purchasers. Nor may he by rule or notice, in absence of contract or statutory right, fix prices for future sales, even though the restriction be known to purchasers. Any right that he has to project control beyond his own sales must depend, not upon an inherent power incident to production and original ownership, but upon agreement. But such agreements are injurious to the public interest and void. The plan, in effect, creates a combination for prohibited purposes. The complainant having sold its product at prices satisfactory to itself, the public is entitled to whatever advantages may be derived from competition in the subsequent traffic.

This case seems to have settled permanently the question for unpatented articles unless, as Justice Holmes pointed out in a dissenting opinion, the manufacturer should make the retail dealers his legal

distributing agents and retain title to the goods until sold. This might put the plan beyond successful attack, but would involve such an extensive reorganization of retail business methods as to make it an impracticable solution.

The second class of cases involves the right of the manufacturer of a patented article to determine its retail price. In Sidney Henry et al. v. A. B. Dick Co. (224 U. S. 1.) the court gave such a broad interpretation to the rights of a patentee that it seemed probable that the power of price control might be upheld in later decisions. But in the later case of Bauer & Cie and the Bauer Chemical Company v. James O'Donnell (often called the Sanatogen case) it was held that "a patentee who has parted with a patented machine by passing title to a purchaser has placed the article beyond the limits of the monopoly secured by the patent act."

Both of these decisions were rendered in cases involving medicines but in their application will affect the right of the manufacturer to fix the prices of groceries as well. At the time of this writing there is still before the federal courts the case of the Kellogg Toasted Corn Flake Company which is being prosecuted for violation of the Sherman Act by fixing the retail selling price of its product. The most important contention of the defense has been the fact that their product is packed in a carton which has a patented device attached. If the manufacturer were able to retain control over his patented product to the extent of determining its retail selling price the strength of the Kellogg defense would be apparent. Under the ruling in the Dick case cited above such a decision by the court seemed probable but in the Sanatogen case the court's attitude is clearer and at present it seems probable that the Kellogg suit will be decided in favor of the government.

There is thus going on a reorganization in the methods of distributing dry groceries. As in other fields, prophecy is unsafe, but it seems probable that uneconomical practices will be checked. Severe competition, especially in the present period of rising prices, will force many retailers out of the field. If distribution of groceries through both wholesaler and retailer is on the whole less wasteful than sale by the manufacturer direct to the consumer, the wholesaler will be retained. If not, he will be as far as possible eliminated. If fixing of prices by the manufacturer is more economical than price cutting we shall doubtless come back to that practice, but at present the tendency is in the other direction.